

the competitive price would be offered could be treated as a single geographic market.⁴⁵

The NPRM proposes to define the relevant product market using existing definitions of current service categories within each access service basket. The NPRM seeks comments on using these access service definitions for defining the relevant markets and, furthermore, indicates that any alternative proposals should be supported.⁴⁶ TW Comm concurs with the NPRM that the single product market which was defined for the IXCs' interstate services is not the appropriate product market for LEC services⁴⁷ because such a market would be overly broad.

The existing price cap service categories generally represent an acceptable foundation for assessing the market power of LECs. Competition may arrive in some product markets earlier than it does in others, and ultimately, it may be appropriate to grant pricing flexibility in certain markets before granting

⁴⁵ The foregoing discussion assumes that the LEC would not be capable of cross-subsidizing the defined competitive market (Manhattan in this example) with higher prices imposed in other noncompetitive markets (e.g., the Bronx). It assumes that joint and common costs exist within a single defined market (Manhattan) but do not exist across separate market areas. Overhead costs vary directly with the scale of a LEC's operations and thus they should be allocated proportionally among the relevant markets. The LEC should be allowed to either (1) demonstrate that such a proportional allocation has been made, or (2) alternatively, if the LEC contends that such an allocation of the overhead costs cannot be made among the markets in question, the LEC should not be allowed to divide the market.

⁴⁶ LEC Pricing Flexibility NPRM at para. 118-119.

⁴⁷ Id. at para. 117.

pricing flexibility in other product markets.⁴⁸ Although the existing service categories are generally useful, there are some particular problems with using them that should be addressed:

- The common line basket includes the end user common line charge and the carrier common line charge, rate elements associated with the non-traffic-sensitive costs of local loops. In assessing whether the common line basket is competitive, it is essential to assess the level of competition that has emerged in the local exchange market, which necessarily requires an evaluation of intrastate services.
- The traffic-sensitive basket of services⁴⁹ may pose problems if the geographic markets are not properly defined or if the Commission prematurely classifies an individual service as competitive. For example, local switching is used for numerous intrastate and interstate services such as custom calling features, local usage, message toll service and switched access. If the Commission defines a geographic market that is too narrow, then anticompetitive problems with this product market designation may ensue because the LEC could shift shared costs from those isolated instances where certain services may face emerging or actual competition to other parts of its market where there is no competitive activity. Assuming the Commission considers a sufficiently broad market (and considers both intrastate and interstate services), and assuming further that the appropriate criteria are applied to a particular product market, then the services in the traffic-sensitive basket can serve as useful designations for product markets.
- The use of the services in the trunking basket as product markets raises several concerns.⁵⁰ The major

⁴⁸ As a fundamental matter, however, as stated previously, TW Comm is extremely skeptical of the need to make such an assessment at any time in the foreseeable future.

⁴⁹ This basket includes four service categories: (1) local switching; (2) information; (3) data base access; and (4) billing name and address.

⁵⁰ This basket includes seven service categories: (1) voice grade flat rate transport, voice grade special access, WATS, metallic, and telegraph; (2) audio and video; (3) high capacity and digital data services (this category includes
(continued...)

concern regards the interconnection charge which is a meaningless "service" because the residual interconnection charge ("RIC") is not a product that a consumer purchases but rather is a rate element that was created solely as a means for recovering the LEC's residual revenue requirement. For example, the tandem-switch service is a meaningful product because it is a service that may be purchased and used without other services. However, this product as well as the tandem signalling service share costs with intrastate MTS services. Until such time as intrastate message toll service is competitive, it would be inappropriate to grant competitive status to tandem-switched transport service or to tandem-switched signalling. Furthermore, the interoffice component of trunking may face effective competition before the local distribution channel does, in part as a result of the Commission's orders regarding collocation for special access and switched transport services, and, therefore, it may be appropriate to consider these two elements as separate products.

In summary, the use of the existing services in the four price cap baskets, subject to the concerns discussed above, could serve as appropriate definitions for the LECs' product markets.⁵¹ In its evaluation of the competitiveness of individual products, the Commission must consider the product's competitiveness within a sufficiently large geographic market (including the intrastate and interstate jurisdiction). These

⁵⁰(...continued)

two sub-categories: DS1 special access and DS1 flat-rate transport and secondly DS3 special access and DS3 flat-rate transport); (4) wide band data and wide band analog; (5) tandem-switch transport; (6) the interconnection charge; and (7) signalling for tandem switching.

⁵¹ The fourth basket is the interexchange basket (for intraLATA, interstate traffic). There are also billing rate elements that are associated with the specific costs and functions of the LECs' interstate services.

levels of scrutiny are necessary to ensure that the LEC's pervasive common costs do not afford it any unfair advantage in the marketplace.

Issues 14a, 14b The Relevant Geographic Market Should Be Sufficiently Large To Prevent The Shifting Of Common Costs Between Competitive and Non-Competitive Markets

The NPRM tentatively proposes to use the density zones that the LECs developed for the provision of expanded interconnection service as the geographic market for access services.⁵² The NPRM states that the relevant geographic market should be sufficiently narrow to encompass only competing access services for the same set of customers, yet be sufficiently broad to be administratively workable.

The NPRM seeks comments on the use of density-based pricing zones, and also on whether other boundaries for markets should be adopted (e.g., LATAs, Metropolitan Statistical Areas, or wire centers). As noted by the FCC, it would not be administratively feasible to use the wire center as the basis of the geographic market because there would be thousands of individual markets. TW Comm opposes the use of wire centers for this reason and also because a wire-center based market definition would create countless opportunities for shifting common costs from wire centers characterized by the entrance of potential competitors to wire centers with minimal competitive

⁵² LEC Pricing Flexibility NPRM at para. 120.

activity.

The Commission also should not adopt density-based pricing zones as the relevant geographic market for assessing competition and granting regulatory relief. There are three density zones for special access and switched transport. Areas with the highest traffic density are designated as Zone 1. As it has been recognized,⁵³ the pricing zones for trunking have developed in a "checkerboard" fashion rather than in contiguous geographic areas. The fact that wire centers in the least competitive market would abut wire centers in more competitive markets creates a significant opportunity for the LEC to shift shared costs among wire centers to pursue unfairly its competitive strategies. Furthermore, as appropriately noted in the NPRM, for example, the pricing zones that exist today are based upon the amounts of trunking traffic, which may not be useful for defining services in the traffic sensitive, common line, and interexchange baskets.⁵⁴

LATAs may be an appropriate geographic market, provided that all customers within the LATA were presented with competitive alternatives; i.e., provided that the LATA for which an assessment of competitiveness was being made did not include geographic "pockets" of monopoly service. Alternatively, TW Comm would support the use of LATAs as the boundaries of relevant geographic markets even where the LATAs included some less

⁵³ Id. at para. 124.

⁵⁴ Id. at para. 124.

competitive subregions if LECs were required to set prices uniformly throughout each LATA. This condition is necessary to ensure that in those instances where a LATA might encompass mainly competitive areas, but also included geographic pockets where customers had no meaningful competitive alternatives, LECs would not be able to shift common costs from the competitive areas within the LATA to the noncompetitive areas within the LATA. This proposed mechanism responds directly to one of the questions posed in Issue 14b.⁵⁵ If prices differed, it would suggest that some of the area was not competitive and the customers in the non-competitive pockets would be at risk of bearing an unfair share of the common costs.

Because of the substantial amount of costs that are shared among geographic areas and among the LECs' telecommunications products, the Commission should guard against balkanization of LECs' markets. Allowing piecemeal pricing flexibility will create enormous incentives to shift the recovery of common costs from geographic markets that face competition to those that do not and from products that face competition to those that do not. Only if there are significant differences in the "non-common" costs that a LEC can demonstrate should the Commission permit geographic de-averaging.

⁵⁵ The Commission asks whether pricing flexibility in an entire study area should be permitted even if a demonstration of competitive conditions has been made only in a portion of the study area. Id. at para. 123.

Background

Issues 15a - 15e Criteria To Be Utilized in Evaluating a LEC's Market Power

The NPRM seeks comment on, among other things, the proposal to "rely more heavily on market forces to achieve [its] public policy goals."⁵⁶ TW Comm urges the Commission to rely on market forces only if and when the market forces are such that they effectively discipline the prices and behavior of the incumbent LECs. The NPRM draws an analogy between the analytical framework the Commission used to streamline AT&T's services with one that it proposes be used for relaxing regulation of the LECs' price cap services.⁵⁷ The standards used by the Commission for declaring AT&T nondominant,⁵⁸ and the standards used during the last decade for granting AT&T gradual pricing flexibility⁵⁹ are the appropriate economic standards for assessing whether a market is sufficiently competitive to warrant the relaxation of regulatory oversight. However, the LEC market is many years away from satisfying these standards. Thus, although the parameters that the Commission identifies are the appropriate measures for

⁵⁶ In re Price Cap Performance Review for Local Exchange Carriers, Order on Motion for Extension of Time, CC Docket No. 94-1, FCC-2340, para. 1 (November 13, 1995).

⁵⁷ LEC Pricing Flexibility NPRM at para. 128.

⁵⁸ In re Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, Order, FCC 95-427 (October 23, 1995) (hereinafter "AT&T Reclassification Order").

⁵⁹ See, e.g., In re Competition in the Interstate Interexchange Marketplace, Report and Order, 6 FCC Rcd 5880 (1991) (hereinafter "Interexchange Order"); In re Revisions to Price Cap Rules for AT&T Corp, Report and Order, 10 FCC Rcd 3009 (1995) (hereinafter "Commercial Services Order").

evaluating the local telecommunications market, any application of these parameters would be extremely premature.⁶⁰

Today's relationship of AT&T to the long-distance market is fundamentally different from that of the LECs' relationship to the access services market for numerous reasons, some of which are:

- AT&T does not control bottleneck network capabilities but the incumbent LECs do.
- From 1984 to 1994, AT&T's market share, in terms of revenues and minutes, declined from approximately 90 percent to 55.2 and 58.6 percent, respectively.⁶¹ LECs still control 99% of the access services market.
- Interstate and intrastate access charge structures have been created and implemented, giving AT&T's competitors "equal access" to the local network. LECs' competitors do not yet have "equal access" to the local network.
- The portability of 800 service numbers has been designed and implemented. Local numbers are not yet portable.
- There are no legal and economic barriers to serving the long-distance market, yet there are substantial barriers to serving the local market.

Generally, sweeping technical and regulatory changes (including the largest corporate reorganization in U.S. history and numerous competitive rulemakings by the Commission) occurred

⁶⁰ To discuss applying these criteria to today's local telecommunications markets would be akin to placing a thermometer into ice water to see if the water was ready for making tea.

⁶¹ AT&T Reclassification Order at para. 67.

over a span of almost two decades⁶² before the Commission lessened its oversight of AT&T. A combination of affirmative regulatory changes and evidence of actual competition preceded the Commission's relaxation of regulatory constraints on AT&T.

Although AT&T and LECs have both been regulated by a system of price caps, and although AT&T and LECs both provide telecommunications services, the similarities of their positions in the markets they serve soon end. We are many years away from being able to meaningfully assess whether it is appropriate to grant substantial pricing flexibility to the LECs. However, despite these fundamental differences in the status of the long-distance and local markets, with the caveats discussed below, the criteria that the Commission has used to measure AT&T's market power in the past are certainly applicable to the Commission's evaluation in the future of the LECs' market power.

⁶² The initial efforts to introduce competition in the long-distance market could be pegged to any of several events. In the mid-1970s, MCI introduced its "Execunet" service, which was the first alternative to the Bell System's switched interexchange message telecommunications service. The Commission initially determined that MCI was not authorized to provide its "Execunet" service, finding that it was only authorized to provide private line service. See In re MCI Telecommunications Corp. Decision, 60 FCC 2d 25 (1976). However, that finding was overturned by the D.C. Court of Appeals. See MCI Telecommunications Corp. v. FCC, 561 F.2d. 365 (D.C. Cir. 1977) cert. denied 434 U.S. 1040 (1978). In 1978, the Commission established a rulemaking that ultimately led to the creation of access charges for interexchange services and equal access to local exchange networks for all interexchange carriers.

Issues 15a and 15b Demand Responsiveness And Supply Responsiveness Should Be Among The Criteria Used By The Commission To Evaluate The Competitiveness Of The Local Market

It is clear that demand and supply elasticity are certainly appropriate criteria for evaluating the potential competitiveness of a market. However, in considering demand elasticity, the Commission should recognize and account for the fact that, unlike in the interstate long-distance market where customers switched among competing providers, customers in the local market may simply supplement the service offered by the incumbent. If customers are not migrating away from the incumbent but choose simply to add redundant service, this fact should be reflected in any analysis of the market's competitiveness.

Barriers to entry directly and substantially influence supply elasticity: substantial capacity held by carriers is immaterial if barriers such as lack of true number portability and lack of network unbundling persist. Therefore, in evaluating supply elasticity, the Commission should critically and comprehensively examine the degree to which a rigorous "competitive checklist" has been satisfied.⁶³

⁶³ As stated earlier, satisfying the competitive checklist does not necessarily transform a noncompetitive market into a competitive one. It is an essential step for enabling competition to evolve, but the fact that barriers to entry have been removed does not in and of itself render a market competitive.

Issue 15c Market Share Should Be The Primary Factor Used By The Commission In Its Evaluation Of The LECs' Market Power

TW Comm concurs with the Commission that market share should not be the sole determining factor of whether a firm possesses market power,⁶⁴ but believes that it is one of the most important factors because market share reflects actual changes in the marketplace rather than the theoretical possibility of structural change. The ultimate indicator of whether a LEC faces real, rather than hypothetical, competition is whether potential competitors have gained and currently hold significant market share. Thus, the market share factor should be given more weight than any other factor. Although a continued high market share by LECs does not necessarily mean that they have complete market power, there is a high correlation between market share and market power.

Market share reflects consumers' actual purchasing decisions and thus provides stronger evidence of the degree to which competitors have successfully entered the market, attracted customers and retained customers than do the other criteria identified in the NPRM. The Commission has asked what data and information would be necessary to assess the relative market shares of the LECs and their competitors.⁶⁵ As noted in one of the Commission's reports, all carriers with interstate revenues have been required to file annual Telecommunications Relay

⁶⁴ AT&T Reclassification Order at para. 68.

⁶⁵ LEC Pricing Flexibility NPRM at para. 143.

Service Fund Worksheets since 1993.⁶⁶ These worksheets enable the Commission to compare separately the revenues associated with several categories of relevant services such as local exchange service and access revenues for the incumbent local exchange carriers and for other providers.⁶⁷ As of 1993, CAPs' revenues for intrastate and interstate access were approximately \$96 million and LECs' revenues for intrastate and interstate access were \$30.6 billion, more than 300 times as much as those of the CAPs.⁶⁸ This report show that as of 1993, incumbent LECs' revenues for local exchange service were approximately \$40 billion, and, as with the access services market, there was not remotely any competition.⁶⁹ Clearly with such an extremely skewed market share distribution, there is no need to gather data at any further level of granularity for the foreseeable future. Ultimately, the Commission may need to revise reporting requirements so that it can gather and evaluate market share data

⁶⁶ Trends in Telephone Service, Common Carrier Bureau, February 1995 at 40.

⁶⁷ Id. at 43.

⁶⁸ Because these are revenue data rather than data on product quantities (e.g., number of voice-grade equivalent private lines or number of DS-1 circuits), they reflect a combination of the relative demand for LECs' competitors' services and the prices that LECs and competitors are able to sustain.

⁶⁹ Trends in Telephone Service at 43. Cellular service carrier revenues were \$19 million, pay telephone operators' revenues were \$10 million; and resellers local exchange service revenues were \$21 million.

that correspond with the product and geographic markets the Commission establishes.

Issue 15d LECs' Pricing Of Services Under Price Cap Regulation Should Be Considered But Afforded Significantly Less Weight Than The LECs' Market Share

In its evaluation of the competitiveness of AT&T's business services, the NPRM notes that after 638 tariff filings in the Business Services Basket 3, AT&T did not exceed the price cap ceiling for that basket and stated, "[w]e believe that these lower-than-required prices for Basket 3 services reflect the competitiveness of business services."⁷⁰ The pricing behavior of LECs similarly may provide clues about the competitiveness of the local market, but such evidence should be examined carefully.

However, the Commission appropriately observes that a LEC's lower-than-required pricing of services is not a reliable measure of competition in markets that lack high supply and demand elasticities.⁷¹ Should the Commission determine that the market is characterized by high supply and demand responsiveness, only then should the Commission consider the pricing behavior of the LECs. Evidence that a price cap LEC is pricing services below the price cap ceiling over a sustained period of time may be evidence that high supply and demand elasticities exist. It could also be a result of other factors and therefore such pricing by LECs should not be given great weight. In assessing

⁷⁰ Interexchange Order at para. 49.

⁷¹ LEC Pricing Flexibility NPRM at para. 145.

any lower-than-required pricing, however, the Commission should also evaluate the presence of any common costs in the market under scrutiny because it is possible that the shifting of common costs from one market to a less competitive market is the reason for the relatively low prices. In this case, the pricing of services below the price ceiling may be an effort on the part of the LEC to create an economic barrier to entry.

Issue 15: The Presence Of Common Costs Is An Essential Factor That The Commission Should Analyze In Any Evaluation Of The Competitiveness Of A Market

While demand and supply responsiveness should be a factor in determining the level of competition, the distinction between resellers and facilities-based providers must be consistently maintained. Ultimately, the Commission should rely on several measures of market power in order to determine if LECs should be granted any pricing flexibility in any of their markets. In its decision that AT&T be classified as non-dominant,⁷² and in its decisions in Docket Nos. 90-132 and 93-137, the Commission evaluated appropriate economic criteria: demand elasticity; supply elasticity (in particular of existing competitors); the relationship of AT&T's prices to the price cap; market share; the cost structures of AT&T and of its competitors;

⁷² Because this decision was issued in October 1995, it could not have been referenced in the LEC Pricing Flexibility NPRM. Nonetheless, TW Comm believes that the analysis reflected in the AT&T nondominant order is directly relevant to this LEC Pricing Flexibility NPRM, and therefore refers to that decision as well as the two referenced AT&T dockets.

and AT&T's size and resources.⁷³ This analysis necessarily and appropriately encompassed an assessment of entry barriers.

TW Comm supports the Commission's reliance on these same measures of market power for evaluating the level of competitiveness in the access services market. In addition, for the reasons discussed above, it is essential that the presence of common costs among adjacent geographic and/or product markets be assessed as part of any evaluation of the competitiveness of a market. If there is compelling evidence of effective competition in all the relevant product markets within a LEC's geographic market, the presence of common costs will be immaterial, but so long as LECs offer monopoly and competitive services and/or serve monopoly and competitive geographic regions, the pervasive presence of common costs should be a primary consideration in the evaluation of LECs' market power. Finally, in assessing the competitive marketplace, the single most important factor is whether or not facilities-based competitors have managed to both obtain and retain more than a thirty percent market share.

Market share should be the primary criterion used by the Commission in its assessment of the presence of LEC market power, because market share, unlike the other criteria, reflects actual changes in the marketplace rather than speculative ones.

⁷³ See AT&T Reclassification Order.

Issues 16a, 16b

**Individually Negotiated Contracts Should
Provide The Public And Competitors With
Detailed Information**

The NPRM proposes to allow price cap LECs to offer contract prices for access services that are found to be subject to substantial competition and streamlined regulation, provided however that the contract rates are made generally available to similarly situated customers under similar circumstances.⁷⁴ Individually negotiated contracts for any services subject to streamlined regulation have a high potential for competitive abuse. Even if the terms of the contracts are purportedly made available to similarly situated customers under substantially similar circumstances, it is difficult, if not impossible, for competitors to determine if they are eligible to receive the service. Individually negotiated contracts therefore create a large risk of price discrimination and predatory pricing by the LEC.

If such contracts are to be allowed, one of the most important protections against market abuse is the accessibility by the public and LEC competitors to detailed information regarding such contracts. The information provided must be of sufficient quantity and quality to allow interested entities to determine whether they are similarly situated and the contracts' impact on the market place. In the past, filings regarding such contracts have provided inadequate information. The greater the

⁷⁴ LEC Pricing Flexibility NPRM at para. 148.

specificity of the information required from the LECs, the less risk of predatory pricing and competitive harm.

**Issues 17,18 Implementation Of Streamlined Regulation Of LECs
Is Not Warranted Due To LECs' Current Market Power**

The NPRM seeks comment on the procedures that should be followed to implement streamlined regulation, as well as the adoption of rules defining the conditions under which LECs would be considered non-dominant.⁷⁵ Such consideration at this time is extremely premature and wasteful of the Commission's resources given the LECs' continuing and tremendous market power. By virtue of the LECs' nearly 100 percent market share and the fledgling nature of their competitors, determining the correct factors that would justify non-dominant regulation for LECs is premature and represents an academic exercise with no likelihood of significance for quite some time. As a result, LECs should be presumed to have market power until they can make a conclusive showing to the contrary. Discussion of non-dominant status for LECs will be far more relevant and appropriate once there is evidence that their monopoly over local services has been eroded substantially.

⁷⁵ Id. at para. 153.

The NPRM asks for comments discussing the circumstances under which the treatment of access charges imposed by LECs and other access providers under AT&T's price cap plan would create actual bias in the access service market. Actual bias as a result of the treatment of access charges imposed by LECs and other access providers under AT&T's price cap plan does not appear to be causing LECs any demonstrable competitive harm, at this time. Absent a showing by the LECs of actual bias and competitive harm the existence of some theoretical possibility of competitive harm does not require any Commission action at this time.

⁷⁶ Issues 19a, 19b, 19c, 20a and 20b will be addressed in a separate response by TW Comm, which will be filed on December 18th, 1995. See In re Price Cap Review for Local Exchange Carriers, Order on Motion for Extension of Time, CC Docket No. 94-1, DA 95-2361 (Nov. 21, 1995).

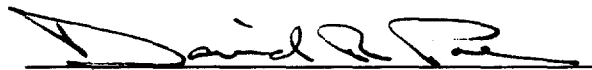
CONCLUSION

In conclusion, TW Comm has substantial reservations regarding the proposals set forth in the NPRM and urges the Commission to modify them in the manner described above.

Respectfully submitted,

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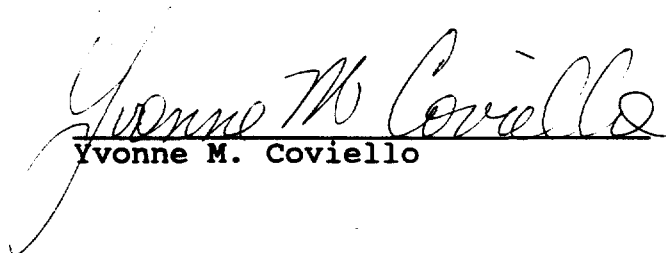
CERTIFICATE OF SERVICE

I, Yvonne M. Coviello, hereby certify that on this 11th day of December, a true copy of the foregoing Comments filed by Time Warner Communications Holdings, Inc., were Hand Delivered upon each of the parties listed:

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